COMMERCIAL MORTGAGE COMMENTARY

CANADA'S MORTGAGE COMPANY.™

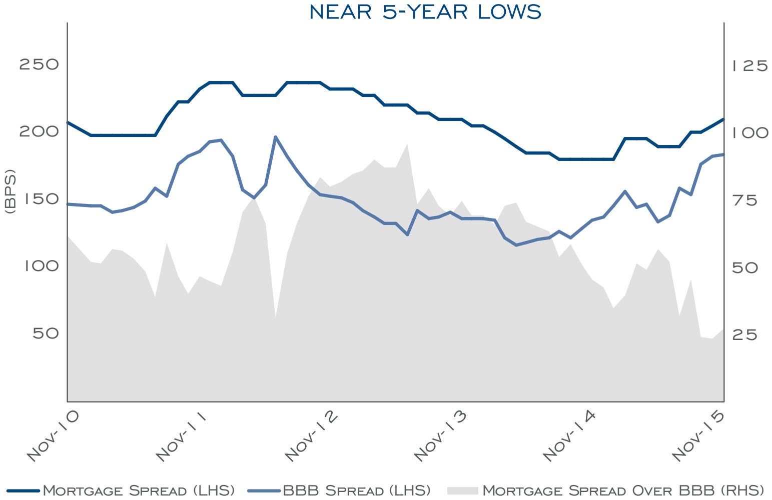
NOVEMBER 2015

Global markets were volatile in Q3/15 and recent economic indicators suggest Canada and the U.S. are on divergent economic glide paths. With the strong October U.S. jobs report, the U.S. Federal Reserve is positioned for its first rate hike in almost 10 years in December, with markets now pricing in a 66% chance of a hike (up from 33% on October 27). The Bank of Canada, on the other hand, is on hold as it awaits a pick-up in manufacturing activity as a result of a stronger U.S. dollar to offset the decline in oil prices and other commodities.

In light of broader market uncertainty, "BBB" corporate credit spreads continued to grind higher, reaching annual highs quarter-to-date in Q4. The increasingly attractive relative value of corporate credits vs. commercial mortgages together with the typical seasonal decline in lender availability is putting upward pressure on conventional mortgage spreads. Many lenders that remain active in the market have increased spreads and/or are restricted by floor rates still in play given the low interest rate environment.

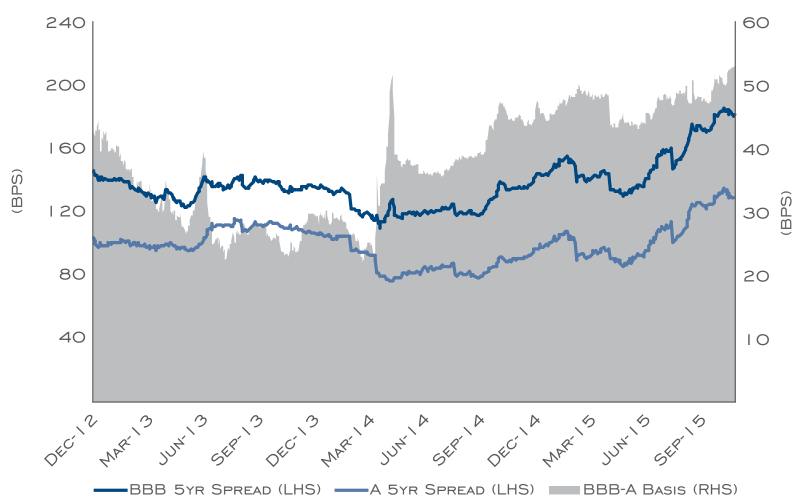
On a relative basis, corporate "BBB" spreads have widened more than corporate "A" spreads since the beginning of the year. Given commercial mortgages and corporates can be substitutes for one another, it's not surprising that we're seeing some lenders become increasingly selective, with spreads widening on lower quality assets or less desirable locations (e.g., Alberta) more so than on A-class assets.

MORTGAGE V.S. CORPORATE SPREAD NEAR 5-YEAR LOWS



Source: Bloomberg, CMLS Financial

BBB-A BASIS WIDENING



Source: Bloomberg, CMLS Financial

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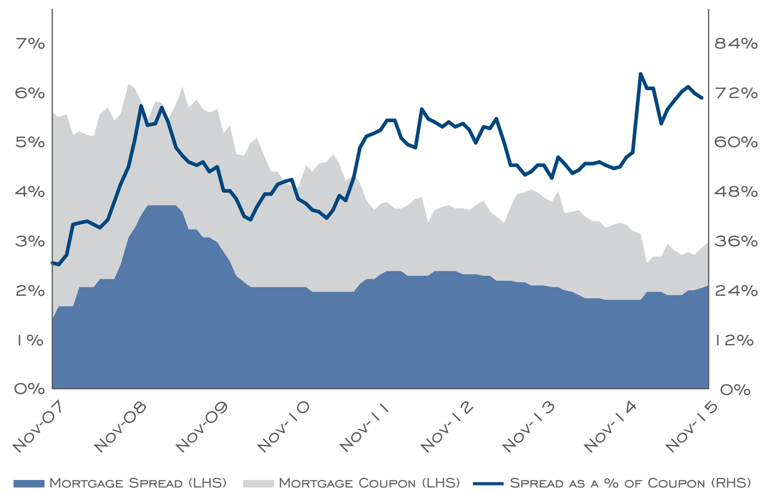
COMMERCIAL SPREADS

Commercial spreads on high-quality assets are currently being priced in the 185 bps to 205 bps range for 5-year deals and 200 bps to 220 bps for 10-year deals, representing a 15 bps to 20 bps increase over Q2/15. This reflects lower seasonal availability from institutional lenders and, more generally, increasingly attractive relative value in the corporate credit market.

Notwithstanding the incremental inch-up in commercial mortgage spreads year-to-date, borrowers can take comfort in the fact that all-in coupons remain at or near all-time lows. On the other hand, credit spreads now make up over 70% of the total mortgage coupon, up from 30% in December 2007, indicating risk now makes up the majority of investor returns.

COMMERCIAL MORTGAGE COUPONS NEAR ALL-TIME LOWS



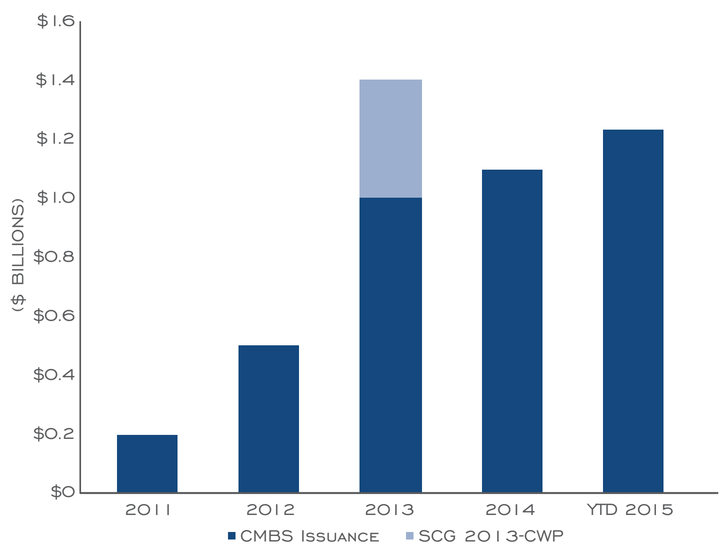
Source: Bloomberg, CMLS Financial

CMBS

CMLS Financial brought a third transaction to the market under the Canadian Commercial Mortgage Origination Trust (CCMOT) banner in late September. At approximately $570 million, the Series 2015-3 transaction was the largest CCMOT offering since the program was created in 2012 and the largest Canadian CMBS offering since the financial crisis. $150 million of the 3.85-year weighted average life ("WAL") "AAA" rated super-senior bonds were offered for sale in Canada only. The bonds priced at a spread of 155 bps over the curve on September 22.

CMBS lender spreads are largely dependent on the price at which issuers can sell CMBS bonds in the credit market. Given the continued up-tick in credit market spreads since Q3/15, we expect CMBS issuance to be muted in the near-term, and CMBS lender spreads to be less competitive than balance sheet lender spreads until the credit markets return to more normalized levels.

CMBS ISSUANCE



Source: CMLS Financial

SUMMARY OF CCMOT DEALS TO-DATE

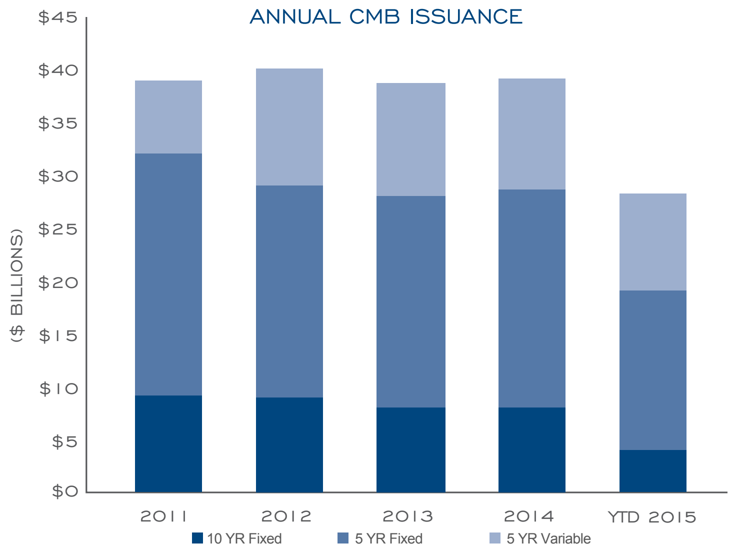
Deal	Cut-Off Date	Issue Size (MMs)	# of Loans	LTV		NCF DSCR		Current A1 WAL
				Original	Current	Original	Current	
CCMOT 2012-1	Oct-12	$248.5	25	60.6%	56.8%	1.66x	1.54x	1.74
CCMOT 2013-2	Dec-13	$393.9	42	60.1%	56.9%	1.45x	1.50x	2.54
CCMOT 2015-3	Sep-15	$570.1	42	59.1%	58.2%	1.49x	1.49x	3.81
Total		**$1,213**	**109**					

Source: CMLS Financial

CMHC

Spreads on new 5- and 10-year multi-family CMHC insured loans are approximately 100 bps, up 20 bps on the 5-year and 10 bps on the 10-year over Q2/15. The increase in spreads is likely due to limited availability as balance sheet lenders and Canadian Mortgage Bond (CMB) allocations have either been filled or are close to being filled for the balance of 2015, with generally less availability of 5-year funds vs. 10-year funds.

Canada Housing Trust issued $22.3 billion of Canadian Mortgage Bonds for the year to date ending Q3/15, of which $15 billion was 5-year fixed with the balance being 10-year fixed or 5-year floating rate note issuances. We expect 3 more CMBs in Q4/15: the re-opening of the 1.95% 10-year December 2025 and a 5-year FRN in November, and a 5-year fixed issuance in December.

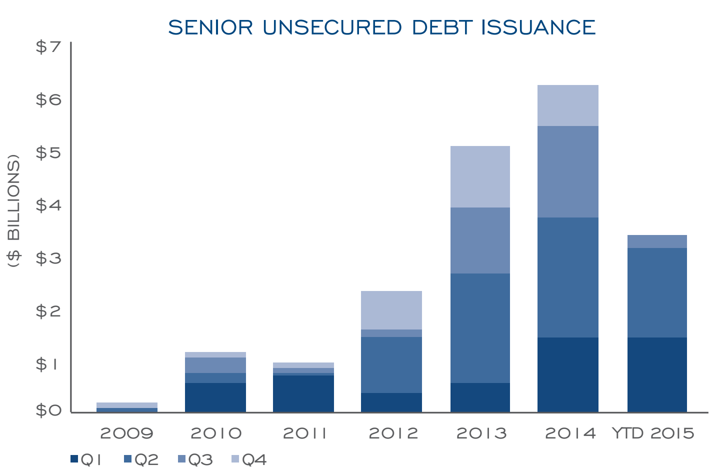


Source: CMLS Financial, CMHC

SENIOR UNSECURED DEBT

The momentum in the senior unsecured market through the first half of 2015 slowed significantly in Q3/15 with only two issuances totalling $275 million. While still a strong year for total issuance-to-date relative to historical standards, it is unlikely 2015 will match the all-time high of $6.2 billion raised in 2014 or the $5.4 billion in 2013.

The largest issuance this quarter was a $200 million, 3.5-year floating rate issue by H&R REIT at CDOR +143 bps. Allied Properties REIT re-opened its May 2020 bonds, issuing $75 million at a spread of 295 bps on August 18, a widening of 22 bps over the May 8 opening of 273 bps. The relative attractiveness of senior unsecured debt has decreased as spreads have widened on unsecured debt at a faster rate than conventional mortgages.



Source: CMLS Financial, Renx, RBC, DBRS, Allied Properties

	Issuer Name	Issue Size Millions ($)	Issuance Rating	Term (yrs)	Spread (bps)
Q1	RioCan	300	BBB (high)	9	222
	Crombie	125	BBB (low)	5	220
	Calloway	160	BBB	10	238
	Choice Properties	250	BBB	6	163
	CREIT	100	BBB	5	186
	Ventas	250	BBB+	7	182
	First Capital	90	BBB (high)	11	213
	RioCan	175	BBB	4	151
Q2	Allied Properties	150	BBB (low)	5	273
	Cominar	300	BBB (low)	7	280
	CT	150	BBB (high)	7	155
	bcIMC	500	AA	10	124
	CT	200	BBB (high)	10	187
	bcIMC	350	AA	6	104
Q3	H&R	200	BBB (high)	3.5	CDOR + 143
	Allied Properties	75	BBB (low)	5	295
	Total	**$3,375**			

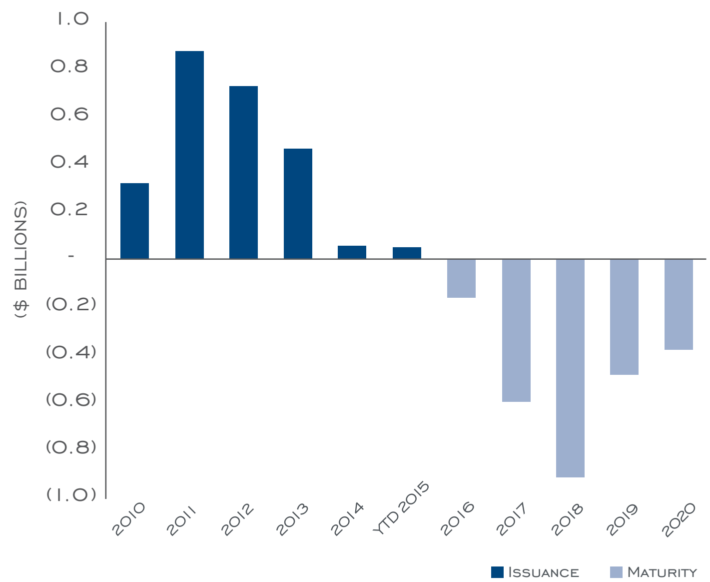
Source: Bloomberg, DBRS, RBC

CONVERTIBLES & NEW ISSUES

Given the weak performance of the equity markets over the past year and a half, it's not surprising that we've only seen one new convertible debenture issue thus far in 2015. NorthWest Healthcare Properties ("NorthWest") announced a $50 million public offering of convertible debentures with a 5.5% coupon and convertible to units of the REIT at a conversion price of $11.25/unit after October 31, 2019 (maturity of October 31, 2020). For unrated issuers, the appeal of convertible debentures is that the conversion feature can reduce the interest rate associated with the debt.

Q3/15 also saw the addition of a new REIT to the public market, bringing the total number of publicly traded REITs to 47. Automotive Properties REIT completed its $81.2 million initial public offering in July. The REIT owns 26 dealerships in Ontario, Saskatchewan, Alberta and British Columbia leased primarily to the Dilawri Group of Companies, or affiliates thereof.

CONVERTIBLE ISSUANCE & MATURITY SCHEDULE



UPCOMING EVENTS

Date	Event
Commercial Real Estate Industry Events	
Nov 19	CREFC Underwriting After-work Seminar (Toronto)
Dec 1	Global Property Market Conference (Toronto)
Dec 2	Real Estate Forum (Toronto)
Economic Data Releases	
Nov 24	Q3/15 GDP Second Revision (US)
Dec 1	September GDP (CAN)
Dec 2	Bank of Canada Rate Announcement
Dec 4	November Employment (CAN & US)
Dec 15	Federal Open Market Committee Meeting (US)
Dec 22	Q3 GDP Third Revision (US)
Dec 23	October GDP (CAN)

NEED MORE SPECIFIC INFORMATION?

For additional details on our spread ranges or any other matter with respect to commercial mortgage valuation in Canada, please do not hesitate to contact our team.

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